MORTGAGE BANKING

AUGUST 1986

The Magazine of Real Estate Finance

56219 SU
SRI ACQUISITIONS
CONGRESSIONAL INFORMATION
SERVICE
4520 EAST-WEST HGWY, SITE 200
BETHESDA, MD 20814

MORTGAGE BANKING

VOLUME 46 NO. 11
AUGUST 1986

ARTICLES

PAGE 10
DIGGING FOR GREATER SERVICING RETURNS
Dr. Victor Cholewicki
This article is an analysis of MBA's newest cost study comparing servicing operations in 1983 and 1984. With the exception of the delinquency and foreclosure problems, the basic fundamentals of servicing cost structure appear to have improved in 1984.

PAGE 34
MULTIFAMILY: FIRST CLASS SERVICING
Hunter Wolcott
Multifamily servicing buyers need to be even more skillful than single-family servicers because each loan is a crucial part of the overall investment. This article details differences between value of servicing and price.

PAGE 44
BUSINESS BASICS—DIALING FOR DOLLARS
James R. Carroll, CMB
This article details the four basic delinquency control criteria. It also is the magazine's introductory article for a new monthly feature; the "Business Basics" column. Effective control of the late payer ultimately means less work, costs and losses.

PAGE 54
MGIC: STEERING CLEAR OF CLAIMS
Mark B. Pollack
MGIC is currently providing a program where the goal is to produce a winning situation for borrowers, lenders and mortgage insurers. Telecounselors and field personnel try to work with borrowers to establish a repayment plan avoiding foreclosure and eventual insurance claims.

PAGE 62
PRIVATE CONDUITS: IT'S NOT JUST A JOB, IT'S AN ADVENTURE
Jess Lederman and Joel VanRyckeghen
The third generation of private conduits is described in this article. Its mission will be to tailor products and programs that meet the originator's needs and then use securitization to create instruments that will be acceptable by institutional investors.

PAGE 73
EMPLOYEE TRAINING: MORE FOR YOUR MONEY
Laurie C. Sain
Practical training will enable employees to provide quality customer service. They will be capable of processing loans, answering questions and dealing with problems effectively. A case study of Guild Mortgage is presented in this article.

PAGE 80
THRIFTS: MOVING OUT OF THE STONE AGE
Peter E. Knight
Thrifts are changing their business tactics to meet new challenges. High interest rates and deregulation forced many S&Ls to shift from portfolio lending to mortgage operations in the early 1980s. Ironically, low interest rates and new regulations will encourage more to do so in 1986.

DEPARTMENTS

ABOUT THE ISSUE	5
BUSINESS BASICS	44
LETTERS	86
PEOPLE	88
BOOKS	94
SECONDARY MORTGAGE MARKETS	99
MORTGAGE MARKET TRENDS	101
AD INDEX	114

DIGGING FOR GREATER SERVICING RETURNS

Servicing operations could be characterized by steady gains in servicing income, relatively stable unit costs of servicing and a rise in profit margins in 1984. However, there were some negative developments as well. Continued high delinquency and foreclosure rates caused a three-fold increase in net loss on foreclosures, a two-fold rise in provisions for loan losses and a sharp increase in the inventory of real estate owned (REO). Productivity, though higher than the relatively low level recorded in 1983, has still not regained its trend rate of the earlier 1980s. In addition, a large number of the most efficient firms in the previous year's survey reported significant declines in productivity in 1984 and accompanying increases in unit servicing costs.

The evolution of an active, well-functioning secondary market in servicing was a key development in the servicing area in 1984. Bulk servicing proved to be far more liquid than in previous years and traded very much like other financial assets. An estimated $80 billion in mortgage servicing changed hands as prices for high quality portfolios rose well above 2½ points in many cases. Government National Mortgage Association (Ginnie Mae) servicing, with relatively high servicing fees and a high degree of transferability, generally commanded the highest prices.

Dr. Victor Cholewicki

ILLUSTRATION BY DOUG KNUTSON

There were several reasons for the surge in the purchase of servicing in 1984. Many mortgage companies had embarked on a "wholesale" strategy in which acquisitions of bulk servicing played a key role. Depository institutions, who could employ servicing escrow balances to particularly good effect, became active acquirers of servicing. Nonfinancial firms, such as General Motors and Owens-Illinois, purchased sizeable mortgage companies, acquiring substantial servicing portfolios in the process. Such firms entered the mortgage banking industry to diversify their sources of income and to cross sell other product lines. Also, many firms both bought and sold bulk servicing during this period, largely to achieve a more efficient portfolio structure. The fact that purchased servicing can be treated as a depreciable asset that appears on the balance sheet proved an added inducement to purchase servicing.

Several factors contributed to the maintenance of supply on the secondary servicing market. Historically, high servicing prices encouraged sales of servicing portfolios. This induced many firms that had traditionally been aggressive accumulators of servicing to sell significant portions of their portfolios during this period. Also, the mid-1984 upturn in interest rates was regarded by many firms to be a transitory phenomenon and they retained their origination staff to position themselves for a subsequent resurgence in origination volume. Although this strategy proved to be correct, some firms found they had to offset their mid-year operating losses by selling servicing. Finally, some firms that incurred marketing losses during the period of rising interest rates sold servicing to maintain cash flow.

Typically, large scale transfers of servicing add significantly to the costs of the purchaser, especially in those cases in which adequate data bases were not included. For survey purposes, large transfers also caused some technical difficulties in the generation of realistic unit cost calculations.

Characteristics of servicing portfolios in 1984

Dollar servicing volume rose in 1984 by only 13.5 percent for surveyed firms. (See Table 1) This was the smallest percentage gain of the past six years surveyed and compares with a 25 percent gain in 1983. Even the low origination years of 1981 and 1982 produced larger percentage gains in dollar volume serviced.

This relatively low rate of growth in 1984 was due to a combination of reduced origination volume among mortgage bankers and a significant increase in the sale of bulk servicing. Relatively high mortgage rates especially around the middle of the year caused substantial declines in mortgage bankers' dollar volume of loans closed. Firms included in both the 1983 and 1984 surveys reported a 20 percent drop in dollar volume originated in 1984. Industry statistics from other sources confirm this sharp drop in origination volume.

Survey respondents added 85 cents worth of loans net to their servicing portfolio for each dollar they originated in 1984. This figure represents the ratio of the increase in the dollar volume of loans serviced to the dollar volume originated and is referred to as the servicing acquisition ratio. The 1984 servicing acquisition ratio of .85 was the lowest of the past six years.

Until 1983, the servicing acquisition ratio remained well over 1.0, indicating that most firms were adding more to their servicing portfolios than they were originating. In 1983, the servicing acquisition ratio fell to .94, largely due to heavy refinancing volume. (Firms refinancing a loan for which they already hold the servicing rights add to originations but not to servicing volume.) Another factor in the relatively low servicing acquisition ratio of 1983 was the relatively high volume of

Dr. Victor Cholewicki is an economist for the Mortgage Bankers Association. He received his Ph.D. in economics from Brown University. Before joining MBA, Dr. Cholewicki served on the faculty at Boston University and at the Catholic University of America.

TABLE 1

Portfolio Dynamics

	1984	1983	1982	1981	1980	1979
Rate of Growth of Dollar Vol. Svcd.	13.5%	25.0%	15.6%	17.4%	18.6%	25.9%
Servicing Acquisition* Ratio	0.85	0.94	1.24	1.65	1.20	1.08

*The ratio of the increase in dollar serviced to dollar originated

"Productivity, though higher than the unusually low level recorded in 1983, has still not regained its trend rate of the earlier 1980s."

originations sold servicing released.

The low 1984 servicing acquisition ratio, on the other hand, was mainly due to a large volume of bulk sales of servicing; refinancings were relatively low in 1984. When mortgage banking firms are classified by type of ownership, only firms controlled by bank holding companies had a servicing acquisition ratio greater than 1 in 1984. They appear to have been net purchasers of servicing during this period.

Servicing Income in 1984

A solid 13 percent increase in servicing income per loan, together with a slight decline in net servicing expense and a moderate rise in the amortization of the cost of purchased servicing, resulted in a 29 percent increase in net servicing income to $79.22 in 1984. (See Table 2) Profit margin rose to 48.2 percent, compared with the unusually low 1983 figure of 42.4 percent. The return of profit margin to nearly 50 percent in 1984 is especially impressive in light of the large delinquency and foreclosure-related items of that year.

Servicing income per loan reached $164.35 in 1984, a 13 percent increase over 1983. (See Table 3) This increase was largely due to the rise in servicing fees to $138.12 per loan compared with the relatively low $123.23 figure of the prior year. (The low 1983 value was attributed to fee splitting, which was much less prevalent in the 1984 survey.) On the average loan size of $34,946, this trans-

TABLE 2

Income Statement: Servicing, Average Firm, 1983–1984

	1984	1983
	Dollars per Loan	
INCOME:		
Servicing Fees		
Servicing Fees, 1st Mortgage Loans	$137.81	$122.91
Servicing Fees, Non-1st Mortgage Loans	0.32	0.32
Net Gain Or Loss On Foreclosure	(4.99)	(1.75)
All Other Income		
Other Loan Administration Income	25.12	22.12
All Other Operating Income	6.09	1.32
Total Gross Servicing Income	$164.35	$144.92
EXPENSES:		
Personnel		
Loan Administration	$ 26.47	$ 27.18
Management not Classified Above	0.22	0.07
Directors	0.03	0.36
All Others	0.21	0.84
Employee Fringe Benefits	4.82	5.21
Occupancy	3.67	3.48
Electronic Data Processing	6.40	5.69
Other Direct Operating		
Equipment Rentals	1.30	1.30
Postage	1.86	2.20
Telephone and Telegraph	3.51	3.79
Office Supplies	2.10	2.60
Travel and Entertainment	0.69	0.76
Automobiles	0.21	0.35
Advertising	0.09	0.09
Legal and Auditing Fees	0.90	0.77
All Other Operating Expenses	8.30	8.52
Provision For Loan Losses	4.20	2.43
TOTAL NET SERVICING EXPENSE	$ 64.98	$ 65.65
Amortization Of The Cost Of Purch. Svcg.	$ 20.15	$ 17.88
NET SERVICING INCOME	$ 79.22	$ 61.39
Number of Firms	111	113

* Due to rounding, parts may not sum to totals.

TABLE 3

Servicing Income:

Income, per loan	1984	1983	1982	1981	1980	1979
Svc Fees	$138.13	$123.23	$118.06	$109.64	$104.19	$88.19
pct incr.	12.1	4.4	7.7	5.2	12.1	
Net Gain Fcl.	$(4.99)	$(1.75)	$(1.11)	$(.92)	$(.16)	$(.28)
pct. incr.	185.1	57.7	20.7	475.0	(42.8)	
All Oth. Inc.	$31.21	$23.44	$21.71	$17.27	$15.61	$13.37
pct. incr.	33.1	8.0	25.7	10.6	16.8	
Total Svc. Inc. per loan	$164.35	$144.92	$138.66	$125.99	$119.64	$101.28
pct. incr.	13.4	4.5	10.1	5.3	18.1	
Total Gross Svc Exp per loan	$85.13	$83.53	$70.19	$58.68	$54.38	$46.29
Net Svc Income, per loan	$79.22	$61.39	$68.47	$67.31	$65.26	$55.00
Margin	48.2%	42.4%	49.4%	53.4%	54.5%	54.3%
Total Svc Income as Pct. Dollar Svcd.	.4703	.4413	.4628	.4546	.4603	.4488
Net Svc Inc as Pct Dollar Svcd.	.2267	.1869	.2313	.2429	.2516	.2437
Servicing Fee as pct. Dollar Serviced	.3943	.3752	.3988	.3956	.4018	.3908
Average Size Loan serviced	$34,946	$32,843	$29,604	$27,715	$25,933	$22,569

lates into a servicing fee as percent of dollar serviced of .3943. a level very near the trend of the 1979-1982 period.

Income in the *All Other Loan Administration* (See Table 2 for definitions) category rose 33 percent, to $31.21 per loan, in 1984 and contributed strongly to the overall servicing income increase. One of its components, *All Other Operating Income*, rose more than 300 percent, reflecting income received from the sale of servicing. This element of servicing income is more dependent on market conditions than on the day-to-day functioning of the servicing operation and can be expected to vary widely from year-to-year. An efficient firm might choose to sell servicing in a strong servicing market year and purchase in a weak year.

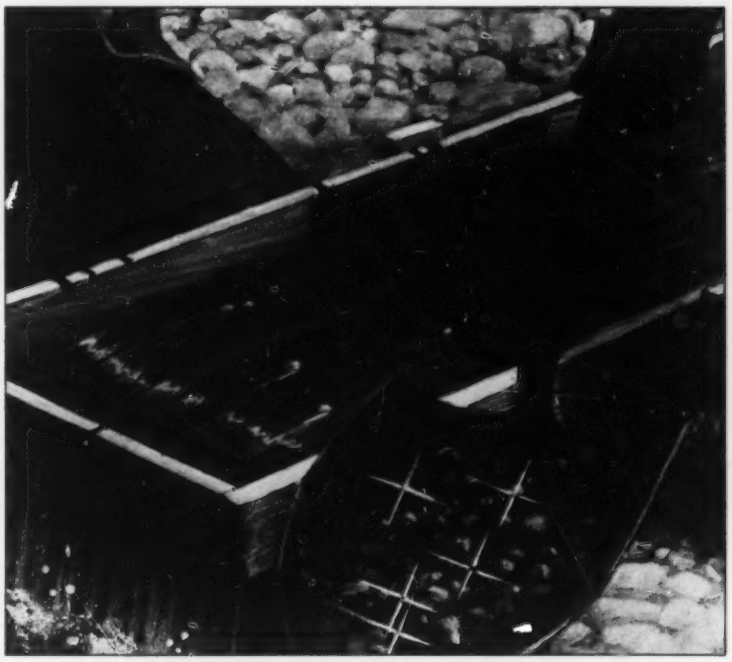
As noted earlier, there was a threefold jump in *Net Loss on Foreclosures.* (See Table 4) This item rose to $4.99 per loan compared with an already high loss level of $1.75 per loan recorded in 1983. Mortgage bankers have been particularly hard hit because they tend to service large numbers of Veterans Administration (VA) and Federal Housing Administration (FHA) loans, which have considerably higher delinquency and foreclosure rates than conventional loans. In addition, the foreclosure losses are generally larger on VA and FHA loans. More restrictive policies of the federal agencies have also raised servicers' losses; this is especially true of the VA's increasing use of its "no bid" option.

Servicers with relatively high average loan balances tend to incur high foreclosure losses. These firms typically hold servicing rights for a high percentage of two- to five-year-old loans in portfolio and foreclosure rates are higher for such loans.

Losses in this area can be expected to continue to grow until an improvement in delinquency and foreclosure rates occurs. Through the first quarter of 1986, this has not yet occurred.

Servicing expenses

Net servicing expense per loan declined to $64.98 from the $65.65 figure of the prior year. (See Table 5) Moderate loan administration personnel salary expenses, an increase in



productivity and a decline in *Other Direct Operating Expenses* per loan were contributing factors to this improvement. The declines in personnel and *Other Direct Operating Expenses* per loan largely offset an almost twofold rise in *Provisions for Loan Losses* and increases in both occupancy and electronic data processing (EDP) costs per loan. The servicing expense ratio —servicing expenses minus the amortization of the cost of purchased servicing as a percent of the dollar volume serviced—fell to .1859 in 1984 from .1999 in 1983—after recording a string of four consecutive increases from 1980 to 1983.

Productivity increased 1.5 percent in 1984 as the number of loans serviced per servicing employee rose to 591 compared with the prior year's 582 figure. Until the upturn in 1984, productivity had been declining since 1981 when survey respondents reported 617 loans serviced per servicing employee, the highest level attained in the past six survey years.

Personnel expenses registered a 6 percent decline in 1984, falling to $31.75 per loan. (See Table 6) In a period of low inflation and wage restraint, salaries (excluding fringe benefits) of loan administration personnel increased a mere 2 percent in 1984 to $15,256. Cost reductions also occurred in the remaining servicing personnel categories and in fringe benefits.

Factors that determine personnel costs per loan, productivity and compensation vary by size of firm, type of ownership and geographical region. In terms of compensation, smaller firms, those with less than $300 million servicing portfolios, typically paid significantly higher average salaries than did larger firms. This is partly due to the fact that in small firms, loan administrators may be required to handle a wide range of functions. Privately held mortgage banking companies averaged loan administration salaries of $14,341, while for firms controlled by bank holding companies (BHCs), the figure was $14,794. Firms in the Other Controlled Subsidiary category (does not include firms controlled by savings and loan associations), on the other hand, averaged $16,055. Salaries (excluding fringe benefits) were highest in the West at $16,652 and lowest in the Northcentral region at $13,879. (See Table 8) Both the Northeast and the South were very close to the national average of $15,256.

Productivity, as measured by loans serviced per employee was also found to vary with size of firm and is also highly affected by the rate of growth of

the servicing portfolio. Either negative or very high rates of growth adversely affect productivity and unit costs. Typically, large firms (more than $600 million in servicing) experiencing moderate growth (0 to 20 percent growth in dollar serviced) attained the best productivity results.

Interestingly, personnel costs, as a percent of total net servicing expenses, have been trending downward in recent years. Personnel expenses accounted for 56 percent of total net servicing expenses in 1980. By 1984, this figure was down to 49 percent.

The 5 percent rise in occupancy expenses per loan serviced in 1984, to $3.67, appears to be largely the result of an increase in rental rates. Occupancy expense per loan administration employee rose 10 percent in 1984 to $2,118.

Occupancy expense also tends to be a function of size of firm, type of ownership and geographical location. Large firms tend to use space efficiently. Firms controlled by BHCs average much lower occupancy expense per employee and per loan than other firms. Their occupancy expense per employee amounted to $1,777, which translates to $2.84 per loan. Other Controlled Subsidiaries incurred occupancy expenses of $2,623 per employee or $5.10 per loan. Occupancy expenses at privately held mortgage companies averaged $2,394 per employee and $4.73 per loan.

Geographical location also significantly affects occupancy costs. Both the Northeast and the West have occupancy expenses per employee well above the survey average, recording $2,416 and $2,337, respectively. Occupancy expenses in the Northcentral states averaged $1,633, while those in the South, at $2,154, fell very near the survey average.

The wide variety of possible data processing arrangements make for significant variances in EDP expenses. Firms may use a service bureau, purchase a system large enough for future, as well as present needs, use a related corporate entity's system in return for an allocation of the cost or own outright a system that has been fully depreciated. For many firms, a determination of the appropriate allocation of EDP expenses over profit centers is an exceedingly difficult task.

TABLE 4

Net Loss on Foreclosures and Provisions For Loan Losses, Per Loan

	1984	1983	1982	1981	1980	1979
Net Loss on Foreclosures	$4.99	$1.75	$1.11	$0.92	$0.16	$0.28
Pct. Incr. Over Prev. Year	185.1	57.7	20.6	475.0	(42.8)	
Provisions for Loan Losses P.L.	$4.20	$2.43	$(0.09)	$0.86	$0.48	$0.29
Pct. Incr. Over Prev. Year	72.8	...	...	79.2	65.5	

TABLE 5

Servicing Expenses Per Loan:

	1984	1983	1982	1981	1980	1979
EXPENSES PER LOAN:						
Personnel	$31.75	$33.66	$29.12	$26.41	$24.73	$22.28
pct. incr.	(5.7)	15.6	10.3	6.8	11.0	
Occupancy	$3.67	$3.48	$3.08	$2.83	$2.18	$1.91
pct. incr.	5.5	13.0	8.8	29.8	14.1	
EDP	$6.40	$5.69	$6.78	$5.57	$4.25	$5.03
pct. incr.	12.5	(16.1)	21.7	31.1	(15.5)	
Oth. Dir. Op.	$18.96	$20.39	$16.25	$12.44	$12.49	$10.54
pct. incr.	(7.0)	25.5	30.6	0.00	18.5	
Prov. Loan Loss	$4.20	$2.43	$(0.09)	$0.86	$0.48	$0.29
pct. incr.	72.8			79.2	65.5	
TOT NET SVC. EXP.	$64.98	$65.65	$55.14	$48.11	$44.13	$40.04
pct. incr.	(1.0)	19.1	14.6	9.0	10.2	
ACPC	$20.15	$17.88	$15.03	$10.58	$10.25	$6.25
TOTAL GROSS SVC. EXP.	$85.13	$83.33	$70.17	$58.69	$54.38	$46.29
Servicing Expense Ratio*	.1859	.1999	.1863	.1736	.1702	.1774
COMPONENTS						
PERCENT OF TOTAL NET SERVICING EXPENSES:						
Personnel	48.9	51.3	52.8	54.9	56.0	55.6
Occupancy	5.6	5.3	5.6	5.9	4.9	4.8
EDP	9.8	8.7	12.3	11.6	9.6	12.6
Oth. Dir. Op.	29.2	31.1	29.4	25.9	28.3	26.3
Prov. Loan Loss	6.5	3.7	0.0	1.8	1.1	0.7

*Net Servicing Expense as percent of Dollar Serviced

TABLE 6

Personnel

	1984	1983	1982	1981	1980	1979
Number of Loans Serviced per Servicing Employee	591	582	611	617	602	591
Pct. Incr. Over Prev. Yr.	1.5	(4.8)	(0.9)	2.5	1.8	
Average Salary, Loan Administration Personnel*	$15,256	$14,995	$13,575	$12,704	$12,202	$10,401
Pct. Incr. Over Prev. Yr.	1.7	10.5	6.9	4.1	17.3	
Total Personnel Expenses, per loan	$31.75	$33.66	$29.12	$26.41	$24.73	$22.28
Pct. Incr. Over Prev. Yr.	(5.7)	15.6	10.3	6.8	11.0	
Personnel Expense as Pct. of Dollar Serviced**	.0908	.1025	.0984	.0953	.0954	.0987
Personnel Expense as Percent of Net Servicing Expense	48.9	51.3	52.8	54.9	56.0	55.6

* Salary of Loan Administration Personnel only; also, excludes fringe benefits.
** Includes Compensation of Other Servicing Employees and fringe benefits

TABLE 7

Income Statement: Servicing by Dollar Volume Serviced, 1984

	Less Than $300 Million	$300 to $600 Million	$600 Million to $1 Billion	$1 to $2 Billion	$2 to $3½ Billion	OVER $3½ Billion
INCOME, per loan						
Svcg. Fees	$147.76	$150.48	$123.18	$139.79	$148.78	$131.73
Net Gain Fcl.	(0.68)	(2.50)	(1.48)	(2.67)	(3.62)	(8.36)
All Oth. Inc.	$ 33.00	29.45	26.83	23.06	30.78	36.82
TOTAL SVC INCOME	$180.08	$177.43	$148.53	$160.18	$175.94	$160.18
EXPENSES, per loan						
Personnel	$ 60.89	$ 39.78	$ 35.48	$ 30.86	$ 28.80	$ 30.56
Occupancy	7.28	4.83	3.96	2.90	4.63	3.07
EDP	13.16	10.88	6.98	5.97	7.39	4.92
Oth. Dir. Op.	33.80	15.79	15.16	17.63	21.03	18.73
Prov. Loan Losses	0.23	0.42	3.22	4.52	3.13	5.60
TOT. NET SVC EXP	$115.38	$ 71.71	$ 64.80	$ 61.85	$ 64.98	$ 62.89
ACPC (Amortization of cost of purchased servicing)	$ 7.51	$ 7.45	$ 8.61	$ 16.26	$ 22.42	$ 21.29
Net Svc. Inc.	$ 57.19	$ 98.27	$ 75.14	$ 82.07	$ 88.53	$ 76.00
Profit Margin	31.8%	55.4%	50.6%	51.2%	50.3%	47.5%
Number of Loans Svcd. per Emp.	400	452	589	614	631	607
Growth in $ Serviced	(1.7)%	14%	11.5%	17%	13%	13%
Servicing Expense Ratio	.2930	.1818	.2099	.1763	.1804	.1836
Avg ln.sz.	$39,381	$39,452	$30,872	$35,086	$36,016	$34,258
Number of firms	24	21	16	23	15	12

TABLE 8

Income Statement, Servicing, by Geographical Region (1984)

	NE	NC	S	W
INCOME; per loan				
Svcg. Fees	$128.93	$118.71	$132.16	$175.38
Net Gain Fcl.	(0.07)	(4.26)	(6.10)	(7.73)
All Oth. Inc.	44.56	27.47	26.84	30.11
TOTAL SVC INC.	$173.42	$141.92	$152.90	$197.76
EXPENSES; per loan				
Personnel	$ 34.93	$ 27.01	$ 28.55	$ 40.22
Occupancy	4.64	2.64	3.42	4.71
EDP	4.88	4.07	7.09	9.09
Oth. Dir. Op.	24.90	16.58	15.62	23.30
Prov. Loan Losses	6.53	5.37	1.56	6.00
TOT. NET SVC EXP	$ 75.88	$ 55.67	$ 56.24	$ 83.32
ACPC	$ 21.69	$ 12.42	$ 20.06	$ 24.68
NET SERVICING INC.	$ 75.85	$ 73.83	$ 76.60	$ 89.76
Profit Margin	43.7%	52.0%	50.1%	45.4%
Loans Serviced per employee	553	642	650	503
Average Salary, Loan Admin.	$15,087	$13,879	$15,116	$16,652
Growth in Dollar Serviced	24.4%	13.5%	14.1%	8.5%
Servicing Acq. Ratio	1.01	1.04	.94	0.53
Servicing Expense Ratio	.2246	.1773	.1700	.1939
Avg ln.sz.	$33,788	$31,403	$33,081	$42,977
Occupancy Expense per employee	$ 2,416	$ 1,633	$ 2,154	$ 2,337
Number of firms	14	24	45	28

*For composition of regions see accompanying geographical regions map

The EDP expense per loan figure can itself be a difficult number to interpret. A low EDP expense per loan could reflect an efficient, automated operation with a high number of loans serviced per employee. Alternatively, it could reflect a firm with little automation and perhaps low productivity. A more useful measure of a firm's degree of automation is its EDP expense per servicing employee. In 1984, this figure was $3,687 or $6.40 per loan. The 1984 figures were higher than their respective 1983 levels, but below the comparable figures for 1982. Firms controlled by BHCs tend to have relatively lower EDP charges. This may be partly due to cost allocation methods but may also reflect the often lighter investor reporting burden of this type of firm, whose parent may be the major investor.

After climbing 64 percent from 1981 to 1983, *Other Direct Operating Expenses* declined 7 percent in 1984 to $18.96 per loan. Significant cost reductions occurred in the postage, telephone and telegraph and other office supplies items. This may be partly due to advances in EDP capability to handle notification letters to borrowers on

adjustable rate loans, which had become widely available at this time.

Provisions for *Loan Losses* have become a significant factor on servicers' income statements in the last two surveyed years, rising 73 percent to $4.20 per loan in 1984 after a major increase to $2.43 in 1983. Typically less than two percent of net servicing expenses, this item jumped to 3.7 percent in 1983 and to 6.5 percent in the following year. Unfortunately, further increases in this item are very likely because the average firm experienced a 70 percent increase in inventory of real estate owned in 1984.

The finding that unit costs stabilized in 1984 may not seem in accord with the experience of some surveyed firms. The changing mix of respondents partly accounts for this. Firms that were included in both the 1983 and 1984 surveys reported significant increases in unit costs and a fall in productivity. These firms averaged less than $60 in unit costs in 1983, while posting 637 loans serviced per servicing employee. In 1984, the corresponding figures were $65.62 in unit costs and 596 loans serviced per servicing employee, figures virtually identical to the 1984 average for all surveyed firms.

A large number of the repeat respondents in both the 1983 and 1984 surveys experienced little change in productivity. For many of those whose productivity declined, it was unusually rapid portfolio growth, a change in organizational structure or major shifts in portfolio due to bulk sales of servicing that increased costs. For others, the greater volume of adjustable rate loan servicing had a significant impact on productivity and cost.

Economies of scale

A major issue in servicing is whether or not unit costs continue to decline as firms grow well beyond $1 billion in dollar volume serviced. The existence of such economies of scale could lead to a major change in the character of mortgage banking that would have an important impact on all servicers. To develop a portfolio of say, $5 billion or more, mortgage banking companies would have to embark on an aggressive acquisition strategy that would probably focus on bulk purchases. The result could be a large number of what are now regarded as large servicers ($600 million to $1½ billion), adding to their portfolios by originating their own loans and purchasing loans servicing released and selling blocks of their portfolios to the "mega-servicers."

The 1983 data raised questions about the extent of scale economies in mortgage banking. It appeared that, at some point, unit costs begin to rise as dollar volume serviced increases. Thus, when the more than $1 billion category in the 1983 survey was broken down into smaller groups, it was found that the $1 to $2 billion category had the highest productivity and lowest unit costs of all categories and that unit costs were significantly higher for the more than $3½ billion group.

The 1984 data, however, tell a somewhat different story. All the major dollar volume size categories over $600 million had roughly similar unit costs. The $1 to $2 billion group had the lowest unit costs at $61.85 and recorded 614 loans serviced per servicing employee. Indeed, many regard this to be the optimal size portfolio from the point of view of unit servicing costs. The $2 to $3½ billion category had somewhat higher unit costs at $64.98 despite recording the highest productivity, 631 loans serviced per servicing employee, of any of the main dollar volume categories. Such firms may have found that growing beyond the $2 billion range required the introduction of an additional layer of management as well as additional facilities and equipment. This causes at least a temporary upturn in unit costs until the additions to personnel and facilities become fully utilized. The more than $3½ billion group had somewhat lower unit costs than the preceding group, at $62.89, but slightly lower productivity, servicing 607 loans per servicing employee.

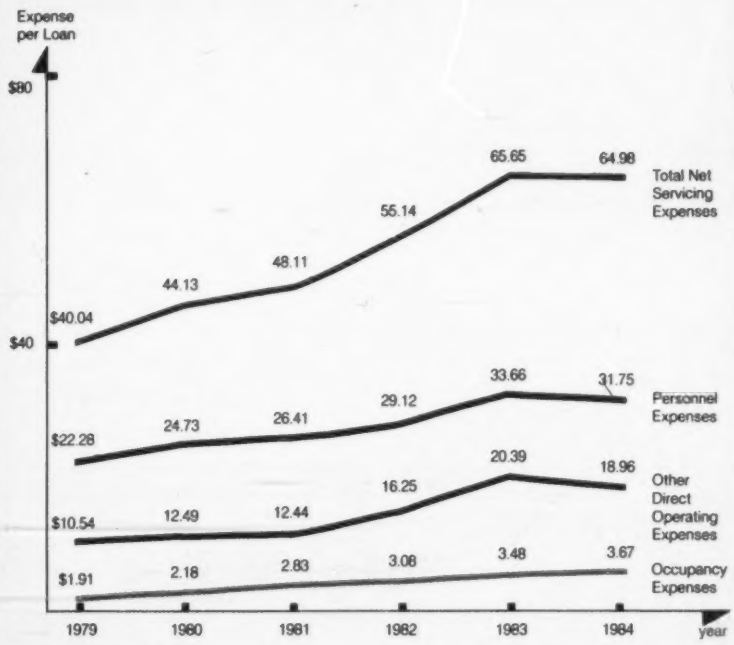
"The evolution of an active, well-functioning secondary market in servicing was a key development in the servicing area in 1984."

The very largest firms—those firms servicing more than $5 billion—were found to have very low unit costs, averaging $57.06 per loan while attaining 614 loans serviced per servicing employee. Most of their cost savings compared with the $1 to $2 billion group occurred in the personnel area. The large servicers' loan administration personnel salary averaged roughly $14,000 per employee, considerably below the industry average of $15,256 and, for example, the $1 to $2 billion categories' figure of $15,018.

The significance of the finding of low unit costs among the largest servicers is tempered, however, by the fact that many smaller firms, some with the less than $1 billion in dollar servicing volume, are also efficient servicers. For example, the $600 million to $1 billion group averaged 589 loans serviced per servicing employee while recording $64.80 unit servicing costs. It is true that the $300 to $600 million category, an efficient size category in the 1983 survey, recorded a disappointing $71.71 unit cost and 452 loans serviced per employee. However, the rather low servicing acquisition ratio of .50 for this category in 1984 could well explain its unimpressive cost figures. Firms in this category experienced an increase in portfolio size of only half their origination volume. They also had an average loan size serviced of $39,452. This often indicates the sale of the servicing rights of seasoned loans while the servicing on new originations was retained. If these firms sold seasoned loans late in the year, their average volume of servicing for the year as a whole exceeded the end-of-year figures on which the unit cost calculations are based. Thus, the unit cost

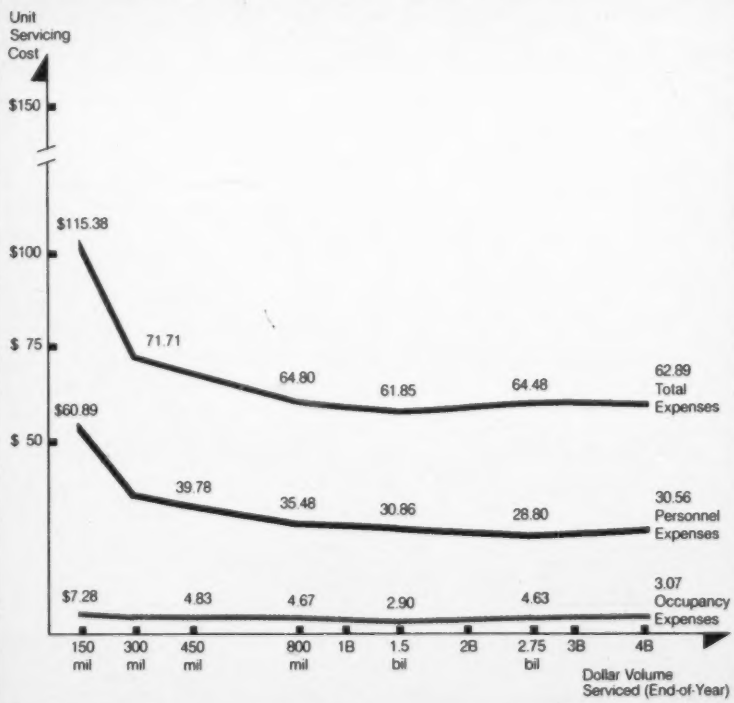
GRAPH 1

Selected Servicing Cost Components, 1979-1984



GRAPH 2

Selected Servicing Cost Components, 1984, by Dollar Volume Serviced



figures for such firms would be overstated.

Thus, there is still reason to believe that firms with more than $300 million serviced can attain relatively good unit cost and productivity figures.

When viewed in terms of number of loans serviced, the size to efficiency relationship becomes clearer. Firms servicing more than 80,000 loans achieved the lowest unit cost, $59.88, of all categories chosen and registered 622 loans serviced per employee. Firms servicing between 40,000 and 80,000 loans achieved nearly as low unit costs, $61.14, with even higher productivity of 651 loans serviced per employee. Significantly lower personnel compensation and other direct operating expenses for firms servicing more than 80,000 loans offset their higher provision for loan losses figure to account for their cost differential relative to the 40,000 to 80,000 loan category firms.

A major surprise was the relatively high unit cost and low productivity levels recorded by firms in the 20,000 to 40,000 loan category. This category registered the lowest unit cost figures in the 1983 survey and has generally been regarded as a highly efficient portfolio size. In 1984, firms in this size category averaged unit costs of $76.40 and 549 loans serviced per employee. However, these figures are largely the consequence of highly dynamic portfolio change by several firms in this category. Many of the firms with high unit cost figures experienced either very high or negative portfolio growth, most being either big buyers or big sellers of servicing. A high rate of portfolio growth can generate high setup costs, the need for additional personnel, etc. Selling large blocks of servicing, on the other hand, can result in large unit cost numbers (especially if the sale was made late in the year), while reducing the end-of-year number of loans serviced. Because the number of loans serviced figure used in generating the unit cost number is the average of beginning and end-of-year number of loans serviced, the denominator of the unit cost measure is disproportionately small. This results in a unit cost number that understates the efficiency of the operation. It also results in a lower productivity figure.

TABLE 9

Type of Ownership

	Bank Holding Co. Controlled	Other Contr'd Subsidiary	Privately Held
All Firms:			
Number of Loans Svcd. per Servicing Emp.	646	533	520
Unit Servicing Cost	$57.35	$77.13	$74.24
Firms With More Than 1 Billion Dollars Svcd.			
Number of Loans Svcd. per Servicing Emp.	662	556	552
Unit Servicing Cost	$56.00	$76.31	$64.16

*Refers to subsidiaries controlled by entities other than Bank Holding Companies or Savings and Loan Associations.

Effects of portfolio growth on costs

Both high and negative rates of portfolio growth tend to have adverse effects on servicing costs. The 64 firms experiencing between 0 and 20 percent growth in dollar volume serviced averaged $58.37 unit costs. Firms with negative growth in dollar volume averaged $75.72, while firms experiencing growth in excess of 20 percent had average unit costs of $76.52.

Firms with negative growth rates face the need to curtail the size of their staffs and perhaps also cut back on overhead expenses. These adjustments take time and so unit costs increase temporarily. Firms with high growth rates, as mentioned earlier, often make large additions to personnel and facilities to prepare for future growth. Their unit costs may also be high during the transition to a larger operation.

The effects of growth in dollar amount of servicing on unit costs depends significantly on the correlation between growth in the number of loans serviced and the dollar volume of servicing. This correlation is not as strong as might be expected. It is not uncommon to find firms with very low rates of growth of number of loans serviced recording relatively high rates of growth of dollar volume serviced. For example, the very heavy buying and selling of servicing that occurred in 1984, as sellers took advantage of unusually high prices paid for portfolios, appears to have widened the disparity between number and dollar volume. Firms selling seasoned servicing in bulk and putting large amounts of newly originated loan servicing on their books could have relatively low rates of growth of number of loans serviced and relatively high rates of growth of dollar volume serviced. It was not uncommon for firms with nearly zero rates of growth of number of loans serviced to experience a growth rate of 20 percent or more in dollar volume serviced.

Type of ownership

Mortgage companies controlled by BHCs enjoyed unusually low unit servicing costs in 1984. Firms in this category averaged $57.35 in servicing cost per loan, far below the unit cost figure of $76.33 for the remaining firms in the study. (See Table 9) These firms also averaged 646 loans serviced per servicing employee compared with the 533 figure for the remaining firms. Privately held mortgage companies averaged $74.24 unit costs and 520 loans serviced per servicing employee, while mortgage banking firms in the Other Controlled Subsidiary category averaged $77.13 and 533 respectively.

A large part of the reason for the relatively low cost recorded by BHC subsidiaries is size differentials and scale economies. On average, privately held mortgage banking firms have smaller servicing portfolios than subsidiaries of BHCs. Among the mortgage banking firms servicing more than $1 billion, the BHCs subsidiaries had an average unit cost of $56.00 and 662 loans serviced per servicing employee; for the large privately held firms, the figures were $64.16 and 552 respectively. The comparable figures for the Other Controlled Subsidiaries were $76.31 and 556.

Besides their high servicing employee productivity, BHC mortgage banking subsidiaries have relatively lower average loan administration personnel salaries and enjoy a relatively smaller allocation of expenses for occupancy and electronic data processing from their parents. Their provisions for loan losses are also lower. The degree to which these cost differences are real, rather than a reflection of differences in cost allocation methodology, however, cannot be determined from available data.

"GNMA servicing, with relatively high servicing fees and a high degree of transferability, generally commanded the highest prices."

Unit costs

There were 20 firms in the 1984 survey with unit costs less than $50. (See Table 10) Of these "low cost servicers," six serviced portfolios of less than $1 billion, while seven serviced portfolios between $1 and $2 billion.

Much of the cost savings experienced by the low cost servicers occurred in the personnel area. The combination of extremely high productivity (733 loans serviced per servicing employee) and relatively low loan administration personnel salaries of $12,543 resulted in personnel costs of only $20.63 per loan. This was sig-

nificantly below the survey average of $31.75.

Those firms with unit costs of between $50 and $60, on the other hand, recorded average salaries of $14,997 and productivity of 633 loans serviced per servicing employee, figures close to the average for surveyed firms. However, both the lowest cost and the $50 to $60 unit cost servicers were well below average for provisions for loan losses per loan. Indeed, it is this item that explains most of the difference between the $50 to $60 unit cost group from the next higher $60 to $70 group.

Firms in the $70 to $80 unit cost group recorded slightly below average productivity of 543 loans serviced per employee while incurring average loan administration personnel salary expenses of $18,158, well above the industry average. This explains both their relatively high $39.41 personnel expense per loan and, as a result, their somewhat above average unit costs.

The effects of a rapid rate of portfolio growth and large scale sales of bulk servicing on unit cost figures is evident when the higher unit cost categories are viewed. Firms with unit costs in the $80 to $120 range experienced a growth in dollar volume serviced of a mere 2.9 percent, while recording a servicing acquisition ratio of .17. These figures indicate large servicing sales, which accounts for the high unit cost figure.

Firms incurring unit cost figures in excess of $120 experienced unusually high rates of portfolio growth, averaging 37 percent over the course of the year. As noted, exceptionally high rates of portfolio growth can add significantly to unit costs.

Geographical regions

Unit servicing costs tended to be highest in the Northeast and the West in 1984, while falling well below the survey average in both the Northcentral and Southern regions of the country. A combination of relatively high loan administration personnel salaries and somewhat below average productivity resulted in an average unit cost of $75.88 for the Northeast region. A high 24.4 percent rate of growth of dollar serviced and large scale purchases and sales of servicing also had a detrimental effect on their cost figures. On the whole, they were net acquirers of servicing in 1984, recording a servicing acquisition ratio of 1.01.

Geographic Regions

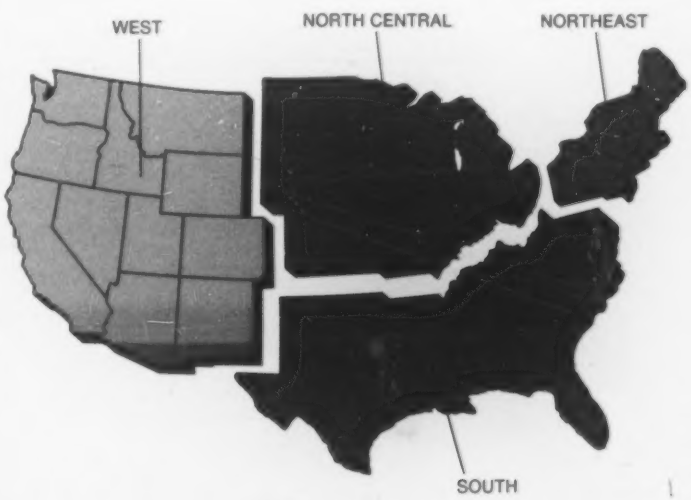


TABLE 10

Servicing Expenses, Per Loan: Grouped by Unit Cost

	Less than $50	$50 to $60	$60 to $70	$70 to $80	$80 to $120	Over $120
Expenses; per loan						
Personnel	$20.63	$31.30	$28.47	$39.41	$46.23	$65.15
Occupancy	2.27	2.81	3.60	5.21	5.27	9.20
EDP	4.83	4.54	6.94	7.09	10.34	10.67
Other Direct	14.29	16.71	17.01	21.13	27.46	39.22
Prov. Loan Losses	0.29	0.52	7.56	1.93	6.99	29.85
TOTAL NET SVC. EXP.	$42.32	$55.88	$63.58	$74.77	$96.29	$154.09
Loans serviced per employee	773	596	633	543	454	352
Average Salary, Loan Admin.	$12,543	$14,997	$14,465	$18,158	$17,482	$17,182
Growth in Svcd.	12.8%	15.8%	12.1%	14.4%	2.9%	37.0%
Servicing Acq.Ratio	.98	1.07	.55	.73	.17	1.31
Average Loan Size	$29,838	$35,219	$35,442	$35,795	$40,123	$50,656
Profit Margin	61.5%	56.5%	49.5%	45.7%	29.3%	22.9%

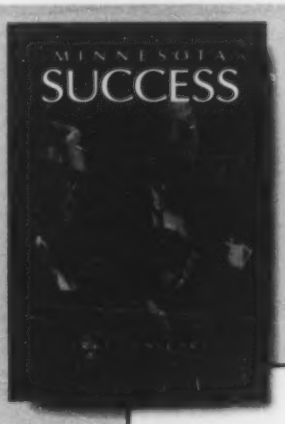
Servicing costs were also high in the West, averaging $83.32 for the 28 firms of that region in the survey. High loan administration personnel salaries, averaging $16,652, contributed to the higher costs. However, large scale shifts in the servicing portfolios of these firms were a more important factor raising their cost figures. The firms in the West recorded a growth in dollar serviced of only 8½ percent while posting a servicing acquisition ratio of .53. Many firms in this region took advantage of the prevailing unusually high prices for servicing, selling much of it toward the end of the year. This means they were servicing a good deal more loans than would be reflected in their beginning and end-of-year volume numbers and incurring the associated costs. Thus, they were much more efficient servicers than the figures would indicate. The average outstanding principal balance of $42,977 serviced by firms in the West was $9,000 more than in any of the other geographical regions.

The question of the relative efficiency of the Western firms can be clarified by confining our attention to those firms in the West that were included in both the 1983 and 1984 surveys. In 1984, the repeat respondents in the West recorded unit servicing costs of $83.61; 496 loans serviced per employee; a 7.1 percent growth in dollar volume serviced; and a servicing acquisition ratio of .51. In 1983, these same firms registered unit costs of $64.25; 586 loans serviced per employee; a 14.4 percent growth in dollar volume serviced; and a servicing acquisition ratio of .82. The major drop in the servicing acquisition ratio in 1984 indicates large scale sale of servicing, which, in turn, accounts for the deterioration in the unit cost and productivity levels.

The lowest unit cost region, on average, was the Northcentral, followed closely by the South. Firms in the Northcentral part of the country had average unit costs of $55.67, while registering 642 loans serviced per servicing employee. Their high productivity, combined with a low $13,879 average loan administration personnel salary, accounted for much of their cost savings. Also contributing to their low unit cost was their moderate 13½ percent rate of growth of dollar serviced. Firms in this region had a servicing acquisition ratio of 1.04. They also had large servicing operations relative to their origination volume. Their ratio of dollar volume originated to dollar volume serviced was .115, the lowest of the four geographic regions.

The South averaged $56.24 in unit servicing costs, while recording 650 loans serviced per employee. The slightly higher productivity relative to the Northcentral region was more than offset by higher average loan administration personnel salaries of $15,116. However, the considerably lower provision for loan loss of $1.56 per loan, compared with the Northcentral region's average of $5.37, put their net servicing expense per loan very near that of the Northcentral region.

With the exception of the delinquency and foreclosure problems, the basic fundamentals of servicing cost structure appear to have improved in 1984. A key to future profitability will be the ability to avoid cost increases associated with problem loans. □



For your free copy, simply return the coupon. Or call toll free: 1-800-328-9343, Ext. 3700. In Minnesota, call 1-800-752-4308, ext. 3700.

FIND OUT WHAT SUCCESS IS ALL ABOUT.

Minnesota is filled with success stories. So is *Minnesota Success*, a new magazine created by Minnesota Mutual.

In this premiere issue, you'll learn how financial institutions like yours use market research to solve problems, approach opportunities and plan for the future. Hear what research industry experts have to say about methods and results. And find information you can use to succeed in the changing financial arena.

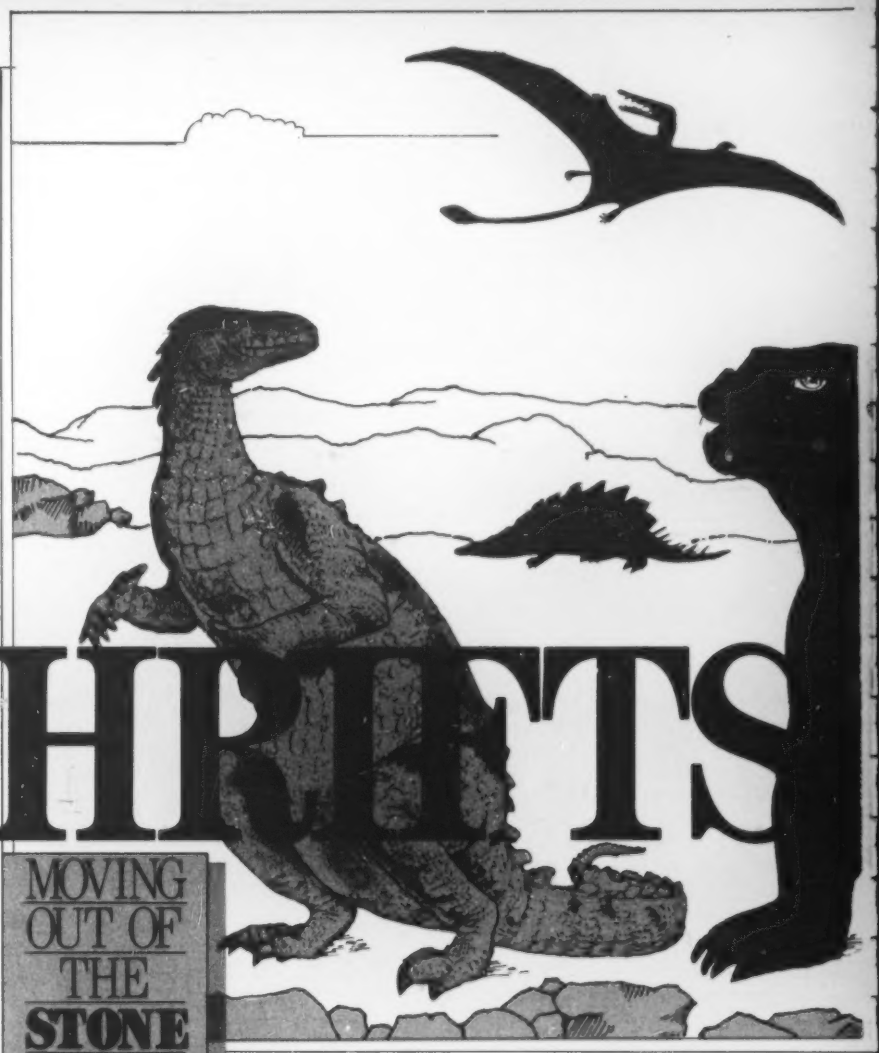
MINNESOTA MUTUAL
WORKING HARD TO MAKE LIFE EASIER.®

Name_____
Title_____
Company_____
Address_____
City_____
State_____ Zip_____

Return to: Minnesota Mutual Life
Dept. 17-3700
400 North Robert Street
St. Paul, MN 55101

©1986 Minnesota Mutual

Peter B. Knight



THRIFTS

MOVING OUT OF THE STONE AGE

Savings institutions have been in an evolving mortgage market for the past 15 years. Regulatory, legislative, technological and market forces have acted in concert to change the nature of the mortgage business. During this period, more and more institutions have dramatically changed their strategy, moving from portfolio lending to mortgage banking. In retrospect, it is easy to see why institutions did so and why more will act similarly in the future.

High interest rates and deregulation forced many institutions away from portfolio lending and into mortgage banking operations in the early 1980s. Ironically, it will be low interest rates and new regulation, in the form of accounting rules, that will encourage even more to do so this year. In addition to these forces, new technology and competitors will create an environment that will be most unforgiving to those not willing to change or adapt to a new financial world. Simply getting into mortgage banking may not be enough and well-defined strategies will have to be devised and implemented.

Out of the stone age

Portfolio lending was profitable and almost risk-free in the past. Money came in at a regulated level (consumers had no savings alternative) and was lent out at a comfortable profit. Lenders and borrowers benefited from this system, but savers did not.

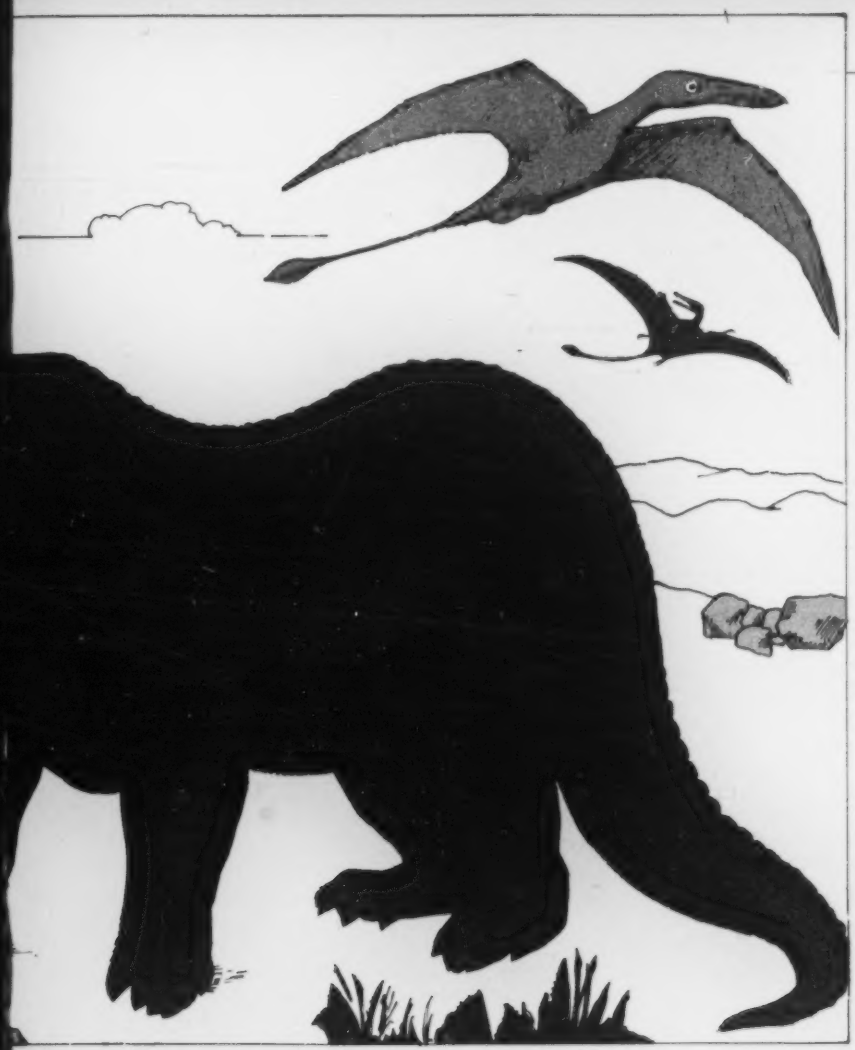
As the savings revolution in the 1970s spawned money market funds with the resulting disintermediation for depository institutions, the blanket of protecting regulations was lifted to expose a shivering industry to the icy winds of a new age. Congress turned a deaf ear on pleas from the savings industry to impose capital requirements on these new funds. The political reaction came, in large part, to the overnight political muscle of the savings alternatives as little old ladies, construction workers and other small savers became sophisticated rate shoppers. This new constituency expressed overwhelming approval for market rates of returns on their deposits. A corollary to the American dream of homeownership became unrestricted access to high yields on savings.

Savings institutions, therefore, found themselves competing with slick new competitors. It was no longer bank versus thrift, but depository institution versus the computer-driven mutual fund. Regulations no longer set rates but capital markets did. To make matters more complicated, the Federal Reserve Board decided in October 1979 that monetary supply and not stability of interest rates, would be its prime concern. While this policy change has been credited for breaking the back of inflation, it killed several thrifts in the process. However, policy makers were willing to accept that price and are still content to back this policy.

The regulatory and legislative policy environment for thrifts, therefore, suggests that no one is willing to guarantee a stable environment. The consumer wants the highest rates of return on savings and the best possible terms on mortgages. No politician is willing to stand between consumers and their desires on behalf of the lender.

First migration to mortgage banking

The deregulation of interest rates and the Fed's policy change resulted in sharply rising costs of funds for savings institutions with fixed-rates of returns on assets. The resulting earning squeeze in 1979 and 1980 forced many thrifts to change their approach to the mortgage business. Instead of gearing profitability to the positive



spread on the portfolio, institutions sought to increase reliance on fee income in the form of mortgage banking.

This phenomenon is best illustrated by data that shows the remarkable increase in the ownership of mortgage banking companies by savings and loans. Chart 1 shows the ownership of the top 100 mortgage banking companies in 1975 and 1985. Every major category decreased with the notable exception of savings institutions.

An example of a major thrift mortgage banking operation is City Federal Savings Bank in Bedminster, New Jersey which is the top Fannie Mae seller/servicer. But Goldome FSB, Buffalo, New York; Commonwealth Savings, Houston, Texas; Anchor Savings Bank, Hewlett, New York; and Gill Savings, Houston, Texas also operate some of the nation's largest mortgage companies and are representative of the major segment of thrifts with well-established commitments to mortgage banking.

ARMs no portfolio panacea

Those thrifts that remained committed to portfolio lending after the tough period of the early 1980s placed much stock in adjustable rate mortgages (ARMs). The feeling was and is that a portfolio of loans that adjust with current interest rates will be protected from interest rate risk.

The first problem the industry had to overcome was restrictive regulations and laws. This was addressed fairly easily. The major obstacle was, however, the reluctance of the consumer to accept the interest rate risk associated with these loans.

After several years of experimentation, the mortgage industry learned that in order to make ARMs palatable, the consumer had to get a sufficiently cheaper rate comparable with a fixed-rate mortgage, in the area of 1.5 to 2 percent and there must be limits on the amount that a loan could rise on an annual and life-of-loan basis. The most popular loan is one with a 2 percent annual cap and a 5 percent life-of-loan cap.

These concessions detracted from the lender's perspective, but many in the industry approached this business with a vengeance. As fixed-rate loans hovered around the 14 percent level, ARMs became the favored instrument of those consumers getting loans, with more than 60 percent of originations being ARMs.

While ARMs were originated in large numbers during times of high interest rates, their performance as portfolio instruments has not been sufficiently tested to draw any finite conclusions, but some trends are emerging. Had rates continued to rise, the obvious concern of many dealt with payment shock. However, because rates have fallen substantially during the past six months, we will not be able to assess the resilience of ARM borrowers.

The major question now facing portfolio lenders with substantial ARM portfolios is at what point will ARMs refinance and will lenders have profited in spite of the concessions necessary to make the loan. Studying ARM refinancing is difficult because there will be no comprehensive data for several months. Conventional wisdom would suggest that adjustable rate loans should not refinance as quickly as fixed-rate loans because borrowers can enjoy lower rates without having to refinance. On the other hand, some believe the borrowers' fixation for a fixed-rate loan is so strong that they will refinance at a similar or higher coupon rate to lock in the assurance of fixed-rate lending.

While current analysis must rely on anecdotal evidence, the emerging trend is startling. Conversations with some at the heart of the market suggest that ARMs are prepaying at an astounding rate and that borrowers are willing to pay points and higher monthly payments to get the security of a fixed-rate mortgage.

Tom LaMalfa, vice president, secondary market services at MGIC, finds that "borrowers are refinancing ARMs at a much higher rate than bor-

about . . .
INSURANCE LOSS DRAFT INSPECTIONS,
DEDUCTIBLES ON BLANKET COVERAGE LOSSES,
PROPERTY INSPECTIONS & PRESERVATION?

LOWEST RATES: $3.00

for property inspections: delinquency & foreclosure reports in selected areas. Maintenance & preservation costs are those allowed. NEVER A NICKLE MORE!

FASTEST NATIONWIDE SERVICES: 12 HOURS

is the guaranteed mortgagor contact time on Insurance Loss Draft Inspections . . . made possible thru centralized operations, 800 telephone numbers & MBA's electronic computer communications. P.S. COMPUTERS PROVIDED.

BROADEST RANGE OF INSPECTIONS

and maintenance including estimate & repair services, claims settlement expertise, low cost appraisal verification, pre-eviction & custom inspections.

FRUSTRATION FREE MORTGAGE SERVICING
the way it should be. . .we guarantee it.

MBA

rowers with fixed-rate loans. Even ARMs currently in the mid-9 percent range are refinancing into fixed-rate loans that are 50 to 75 basis points higher." Dale P. Riordan, executive vice president at Fannie Mae concurs. "We are seeing borrowers with ARMs taking higher fixed-rate loans, plus the points associated with originating the new loan." LaMalfa predicts that of the $250 billion in ARMs originated since the fourth quarter of 1982, only $125 to $150 million will remain on thrifts' books by the end of the third quarter of this year.

If these observations prove to be indicative of the refinancing of ARMs, then the concept of the ARM as an ideal asset for thrifts has been shaken. ARMs that must be generated with a loss leader or discounted rate may encounter either credit quality problems with rising rates, or will be converted to fixed-rate loans with falling rates.

Computers abetting trend to mortgage banking

A dissertation on the mortgage market cannot be complete without a recognition of the effects of technology. Computers have helped lay a foundation for a truly national mortgage market, with rates and terms quoted instantaneously. Computers have made it harder for a portfolio lender to benefit from an inefficient market that enabled high yielding loans to be booked. Thanks to computers, no community is too small not to be plugged into the national market.

Computers have also brought down

CHART 1

Owners of 100 Largest Mortgage Companies

Company Affiliation	1975	1985
Banks	37	32
Privately Owned	46	26
Savings and Loans	4	26
Financial Service Co.	7	10
Industrial Firm	3	3
Homebuilder	3	3

Source: Presented by Terry W. Malone at the MBA National Mortgage Servicing Clinic, February 1986

Peter E. Knight is vice president and director of mortgage finance at the National Council of Savings Institutions in Washington, D.C. He is the author of several articles on mortgage finance and serves as editor of International Capital Markets Report.

interest rates on mortgages and decreased the attractiveness of the portfolio instrument by creating new ways of tapping capital markets more efficiently. Collateralized mortgage obligations (CMOs), a computer-driven financial product developed by so-called rocket scientists on Wall Street, make it possible to raise money for fixed-rate loans more cheaply.

On the positive side, computers have enhanced the attractiveness of mortgage banking by increasing the profitability of servicing. Without computers, servicing could not be the profit center now established by so many thrifts. The liquidity of servicing has also been computer-assisted which enhances it as an asset.

Computers have also enabled new players to enter the market. While some computer-based mortgage origination systems have been slow to get off the ground as planned, such as RNMA (the Realtors National Mortgage Association) and Loan Express, computers are helping facilitate nationwide operations that may well grow to be major market players in the next few years.

The epoch of the mid-1980s

That leaves us in the mid-1986 stage of the continuing evolution of the mortgage market. The poor portfolio lender has been battered by the rising rates and deregulation of the late 1970s and early 1980s. Surprisingly, he has been further tested by falling rates as ARMs and high coupon fixed-rate loans convert to lower rate fixed loans.

This falling rate market will encourage more thrifts to enter mortgage banking in an effort to eliminate the risk embodied by portfolio lending. Now is a good time to do so because the volume of business being written this year will shorten the time frame necessary to reach a critical mass of profitability.

Another major incentive for portfolio lenders to sell loans comes from the bastion of the accounting industry, the Financial Accounting Standards Board (FASB). New FASB rules becoming effective this year will further penalize portfolio lending by having all loan fees amortized during the contractual life of the loan while sold loans may have all their fees booked as income. Because mortgage loan fees represent a substantial part of the industry's profits, many institutions will consider selling loans for the first time so that they can immediately book fees as income.

> "Simply getting into mortgage banking may not be enough and well-defined strategies will have to be devised and implemented."

Accounting treatment for servicing spreads also provides an important incentive for some institutions to enter mortgage banking. Current practice is for the seller to take into income the present value of the interest differential which exceeds the normal servicing fee for the contractual life of the loan. This follows the savings and loan audit guide.

Some lenders are selling current loans at a loss to create inflated servicing spreads. For instance, if the required yield of Fannie Mae is 11.0 percent, most loans are originated at 11.375 percent to include the servicing fee. In this case, a lender would sell the loan to Fannie Mae with a coupon of 10 percent and retain a partial participation of 100 basis points. While the institution takes a loss on the sale of the loan, it may book as income the present value of the interest in excess of the servicing fee, which will more than compensate for the loss on the sale.

CHART 2

	1983	1984	1985
Mortgage Debt Outstanding	$1.81 trillion	$2.02 trillion	$2.25 trillion
Change from Previous Year	—	**11.6%**	**11.4%**
Portfolio of 20 Largest Mortgage Servicers	$133.2 billion	$152.8 billion	$209.4 billion
Change from Previous Year	—	**14.7%**	**37%**

Source: SMR Research Corporation

SEEKING J/V PARTNER

Rapidly expanding Southern California Mortgage Corp. is seeking an institutional joint venture partner to enter full service mortgage banking operations.

Present concentration of loan production is in highly desirable Orange County. Current loan production in excess of $60 million.

Excellent opportunity for mid-sized institution to expand loan portfolio base and servicing income potential.

Principals Only

CALIFORNIA MORTGAGE CONSULTANTS INC.

Direct all inquiries to:

Roxy L. Root, President
California Mortgage Consultants, Inc.
26141 Marguerite Parkway
Mission Viejo, CA 92692

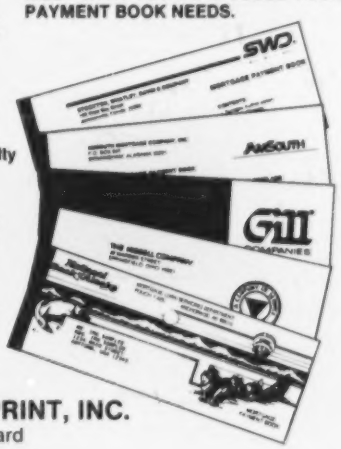
OVER 5,000 FINANCIAL INSTITUTIONS COAST TO COAST, HAWAII & ALASKA

HAVE DISCOVERED THE FASTEST, MOST RESPONSIVE AND DEPENDABLE SERVICE LEVEL IN THE COUNTRY.

OUR CUSTOMERS WILL VERIFY OUR REPUTATION AND OUR RESPONSIVENESS TO THEIR NEEDS. OVER 95% OF THE WORK COMING INTO OUR OPERATION IN BIRMINGHAM, ALABAMA IS COMPLETED AND IN THE MAIL WITHIN ONE WORKING DAY.

CALL OR WRITE US TODAY. ASK ABOUT OUR COMPANY, OUR PEOPLE AND OUR SERVICE LEVEL. LET US MEET WITH YOU TO DISCUSS YOUR PAYMENT BOOK NEEDS.

- **Installment or Mortgage Loans**
- **Superior MICR or OCR Print Quality**
- **Laser Print Technology**
- **Guaranteed Service Level With Penalty**
- **Extended Price Guarantee**
- **We Specialize in Payment Books**
- **Excellent Range of Product Options**
- **Highest Level of Technical Expertise**
- **Data Transmission**
- **In-House Graphics Capability**



FOR ADDITIONAL INFORMATION
Contact: Gary Aderhold, CDP
Senior Vice-President/Sales

NATIONAL COMPUTER PRINT, INC.
5200 East Lake Boulevard
Post Office Box 97
Birmingham, Alabama 35201-0097
205/849-5200
"PAYMENT BOOK SPECIALISTS"

Now Get REO On The *Fast* Track

new accounting & tracking software

Based on actual needs of our consulting clients, FSCG is now offering a software package for managing and disposing of REO properties. Efficiently. Profitably. Fast.

Powerful and easy to use, the package runs on IBM PC/XT, PC/AT and multi-user microcomputers with fixed disk storage. Important features for you include:

- Reduced losses from foreclosed loans
- Reduced clerical, tracking & accounting costs
- Identification of problem areas to reduce # of REO's
- Data on costs, net position & reserve needs

One-time license fee $3,000. Software maintenance and installation assistance is available.

Call Clark Riffe or Lynn MacEwen at (904) 737-4177.

FloridaSystems
CONSULTING GROUP, INC.
7954 Baymeadows Way, Suite 111
Jacksonville, Florida 32216

The big get bigger

If all this has not been difficult enough for portfolio lenders, new players are emerging on the market that are highly capitalized and backed by some of the nation's largest manufacturing, insurance and retail corporations. They are aggressively operated and hope to take a major part of the business from all existing mortgage participants, mortgage bankers as well as portfolio lenders.

A recent study, "The Consolidation of the US Mortgage Industry," published by the SMR Research Corporation in Budd Lake, New Jersey, examines the trend to a national market with fewer, bigger players.

Stuart Feldstein, president of SMR, commented, "The largest players in the market are growing two to three times as fast as the overall market which is symptomatic of an industry going through dramatic consolidation." Chart 2 reflects this trend as the growth in servicing by the largest players has outpaced the growth in the volume of outstanding loans.

This development will accelerate according to the SMR study and put added pressure on thrift management to study its market and role therein. The question arises then of not only what to do with the mortgage once originated, but also how to obtain that business in the first place. In a year of record originations in the $300 billion plus level, there is more than enough business to go around. The study asks though, what happens to the future market when origination volume recedes to more normal levels.

How are thrifts meeting these new challenges? Feldstein observes, "You see some savings institutions doing interesting and exciting things in the mortgage field and others burying their heads in the sand as the world changes around them."

Thrifts that are ignoring change are outweighed by those who are changing their business tactics to meet the new challenges of a further evolving market. Any business plan in the future must be based on careful analysis, planning and be backed up by forceful implementation. The market of tomorrow will be much less forgiving than that of the past. □

MORTGAGE MARKET TRENDS

Just when we thought the party might be ending as the rise in interest rates this spring began easing mortgage loan demand, interest rates once again reversed direction, with the three-month Treasury bill rate falling by about 65 basis points during the last month to the lowest level in almost nine years. To be sure, the behavior of interest rates during this economic recovery has been dramatically different from what was experienced during the cyclical expansion of the latter half of the 1970s. For example, between the tenth and eighteenth quarters of the last recovery, interest rates on bellwether 10-year Treasury securities increased by more than 170 basis points. In sharp contrast, during the comparable period of the current recovery, rates on 10-year Treasuries fell by 560 basis points. As a result, residential lending and construction activity has been exceptionally strong and recent developments confirm the view that the interest rate environment will remain conducive for a continuation of healthy housing activity for some time.

Until recently, most forecasters, including the Mortgage Bankers Association believed that the sharp drop in interest rates and oil prices, the stock market rally and the decline in the foreign exchange value of the dollar during the last year, would together generate an acceleration in economic growth during the second half of this year. In turn, this pickup in growth was expected to put modest upward pressure on interest rates as the year progressed. It is now apparent that this widely anticipated improvement in second half growth from the lethargic first half pace has been postponed or may not materialize at all this year.

In the first place, business investment expenditures are likely to remain flat in the face of stubbornly high excess capacity. So far in 1986, manufacturing capacity utilization has averaged 79.5 percent, compared to 85 percent during the comparable period of the recovery in the late 1970s. Moreover, the negative effects of declining oil prices on total investment activity have been underestimated, and the upcoming passage of tax reform legislation will aggravate an already weak investment spending outlook due to the loss of the investment tax credit and cutbacks on depreciation allowances. Further, the anticipated pace of consumer spending will provide only limited opportunities for a rebound in inventory investment spending. Thus, industrial production is not likely to get much of a lift from an improvement in business investment.

At the same time, despite the sharp drop in the foreign exchange value of the dollar over the last year, the U.S. merchandise trade deficit remains frustratingly large. While U.S. export growth has been improving slowly, import competition remains fierce as foreign producers have slashed profit margins rather than raise their prices. Although import penetration will eventually slow down as foreign manufacturers are forced to raise their prices, it is now clear that improvement in the trade balance will be slow going. As a result, the trade deficit will impart a greater than anticipated drag on industrial production this year. This in turn, will severely limit the improvement in manufacturing sector employment that supposedly would provide renewed vigor to wage and salary growth this year.

In addition, although the sequestration provision of the Gramm-Rudman-Hollings (GRH) legislation has been declared unconstitutional, fiscal policy is, nevertheless, predicted to be less stimulative than it has been in recent years. The conventional wisdom is that while the GRH budget deficit targets will not be met, the budget deficit will gradually be lowered through a combination of modest spending cuts and tax increases.

Thus, the combination of an emerging picture of continued slow growth and upcoming legislative developments that could further limit improvements in the immediate pace of economic activity, fostered a change in market sentiment that halted and reversed the recent uptick in interest rates. Rather than anticipating a gradual firming in monetary policy in response to a faster-growing economy, financial markets correctly anticipated further stimulative moves by the Fed to shore up a sagging economy. The recent drop in the Fed discount rate to 6 percent from 6.5 percent confirmed these expectations.

These developments strongly suggest that housing activity will remain on the high road at least through the summer and possibly into the new year. Interest rates on 30-year, fixed-rate mortgages are headed back into the single digits and could stay there through the year. Just how low they go will depend on the strength of loan demand unleashed by the downward drift in rates. No doubt, refinancing activity, which began to level off in the late spring will remain strong. Although it seems improbable that a repeat performance of the torrid flood of refinancing applications experienced in April and May will occur, this component of loan demand will remain substantial this year as long as rates stay below 10 percent. Housing sales-related originations will also stay brisk, although housing sales may begin to slow later in the year if employment and real income growth fail to respond to the monetary stimulus presently in the pipeline. Clearly, at this juncture, deterioration in job creation and income growth pose a greater immediate threat to the housing recovery than does an upturn in interest rates.

Overall, residential loan origination volume could well exceed $400 billion for the year, with refinancing accounting for 35 to 40 percent of that total. Mortgage bankers will most likely experience a pronounced increase in market share as they traditionally benefit from periods of strong demand for Federal Housing Administration/Veterans Administration loans and fixed-rate mortgages in general. As such, the principal challenges facing mortgage bankers through the remainder of the year will continue to be in the timely processing of loan applications and in adequately hedging pipeline risk in what has been a most volatile year.

Edison R. Zayas
Senior Economist
July 15, 1986

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS: Actual Total	Actual 1-4 Units	Actual 5+ Units	Seasonally Adjusted Annual Rate Total	Seasonally Adjusted Annual Rate 1-4 Units	Seasonally Adjusted Annual Rate 5+ Units	PERMITS 17,000 ISSUING PLACES: Actual Total	Actual 1-4 Units	Actual 5+ Units	Seasonally Adjusted Annual Rate Total	Seasonally Adjusted Annual Rate 1-4 Units	Seasonally Adjusted Annual Rate 5+ Units
1985												
DEC	115	71	44	1,882	1,181	701	128	68	60	1,839	1,077	762
1986												
JAN	116	79	37	2,034	1,442	592	119	74	45	1,861	1,187	674
FEB	107	71	36	2,001	1,317	684	684	68	41	1,808	1,155	653
MAR	151	104	47	1,960	1,305	655	152	99	53	1,834	1,150	684
APR	190	128	62	2,039	1,345	694	180	125	55	1,885	1,256	629
MAY$_P$	190	136	54	1,888	1,346	542	170	121	49	1,785	1,216	569
1985 TOTAL	1,741	1,165	576				1,733	1,077	657			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
5 MONTHS												
1986	753	518	235				732	486	246			
1985	691	472	219				687	440	247			
1984	730	510	220				727	474	253			
1983	633	451	182				602	402	200			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS: Actual North East	Actual Mid-West	Actual South	Actual West	Seasonally Adjusted Annual Rate North East	Seasonally Adjusted Annual Rate Mid-West	Seasonally Adjusted Annual Rate South	Seasonally Adjusted Annual Rate West	PERMITS 17,000 ISSUING PLACES: Actual North East	Actual Mid-West	Actual South	Actual West	Seasonally Adjusted Annual Rate North East	Seasonally Adjusted Annual Rate Mid-West	Seasonally Adjusted Annual Rate South	Seasonally Adjusted Annual Rate West
1985																
NOV	20	17	57	30	235	210	767	442	21	16	52	32	268	206	725	469
DEC	17	13	57	34	283	261	870	468	19	17	62	30	263	271	844	461
1986																
JAN	14	10	62	29	350	318	909	457	14	12	58	34	290	314	767	490
FEB	13	11	51	33	404	370	745	482	12	12	53	32	287	306	743	472
MAR	21	21	69	40	332	344	763	521	21	20	64	46	276	287	718	553
APR	30	33	79	51	335	370	799	535	29	33	69	49	302	333	727	523
MAY$_P$	26	28	80	55	252	247	839	550	28	31	62	50	273	298	682	532
1985 TOTAL	252	240	782	468					260	237	753	484				
1984 TOTAL	204	243	866	436					201	212	812	457				
5 MONTHS																
1986	103	103	338	209					105	107	309	212				
1985	83	83	333	193					98	82	314	194				
1984	63	83	391	194					73	80	371	203				
1983	57	70	367	140					54	63	344	142				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands) EXISTING HOUSES[1]	NEW HOMES Sold	NEW HOMES Available For Sale	NEW HOMES Months Supply at Current Rate	VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions) Seasonally Adjusted Annual Rate Total	1 Unit	2+ Units	Non-res.	CONSTRUCTION STATUS (Units in thousands) Seasonally Adjusted Annual Rate Under Construction Total	1-4 Units	5+ Units	Completions Total	1-4 Units	5+ Units
1985														
DEC	219	47	350	5.7	$219.4	$88.6	$30.1	$100.7	1,089	618	471	162	113	49
1986														
JAN	213	55	351	6.0	224.0	92.9	29.9	101.2	1,094	628	466	122	81	41
FEB	218	59	342	5.9	225.1	94.8	29.8	100.5	1,110	638	472	118	76	42
MAR	277	88	332	4.5	221.1	95.7	30.8	94.6	1,099	627	472	133	92	41
APR	336	82	336	4.8	224.4	97.6	31.7	95.1	1,133	639	494	129	95	34
MAY[p]	329	72	334	5.4	224.5	99.8	32.1	92.6	1,134	651	483	147	94	53
1985 TOTAL	3,214	688										1,703	1,167	534
1984 TOTAL	2,868	639										1,652	1,137	515
5 MONTHS														
1986	1,373	356										649	438	211
1985	1,225	295										624	423	201
1984	1,200	293										610	416	194
1983	1,050	270										406	285	121

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED
By Type of Institution and By Unit Type
(Dollars in millions)

YEAR AND MONTH	TOTAL Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	1-4 UNITS Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JUL	$31,407	$6,503	$11,709	$11,051	$2,144	$21,273	$5,969	$9,093	$6,110	$101
AUG	34,928	7,792	13,324	11,832	1,980	25,518	7,028	10,996	7,390	104
SEP	35,188	7,422	13,316	12,346	2,104	24,104	6,963	10,483	6,541	117
OCT	36,525	6,548	14,014	13,288	2,675	24,450	6,104	11,032	7,208	106
NOV	32,864	5,660	12,363	11,886	2,955	21,142	5,200	9,357	6,491	94
DEC[p]	43,586	5,730	15,919	16,189	5,748	22,814	5,158	10,101	7,162	393
1984 TOTAL	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
1983 TOTAL	274,751	63,430	103,882	91,500	15,939	197,617	59,762	81,524	55,605	726
12 MONTHS										
1985	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
1984	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
1983	274,751	63,430	103,882	91,500	15,939	197,617	59,762	81,524	55,605	726
1982	132,168	30,729	43,433	49,637	8,369	92,512	27,995	34,783	29,190	544

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JUL	$1,804	$53	$974	$604	$173	$8,330	$481	$1,642	$4,337	$1,870
AUG	2,201	239	1,085	665	212	7,209	525	1,243	3,777	1,664
SEP	2,202	287	1,099	656	160	8,882	172	1,734	5,149	1,827
OCT	2,694	150	1,456	700	388	9,381	294	1,526	5,380	2,181
NOV	2,545	183	1,401	716	245	9,137	277	1,605	4,639	2,616
DEC[p]	5,048	274	2,935	1,111	728	15,724	298	2,883	7,916	4,627
1984 TOTAL	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
1983 TOTAL	16,169	566	8,521	5,485	1,597	60,965	3,102	13,837	30,410	13,616
12 MONTHS										
1985	28,034	2,396	15,604	7,262	2,772	99,835	3,011	20,482	52,387	23,955
1984	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
1983	16,169	566	8,521	5,485	1,597	60,965	3,102	13,837	30,410	13,616
1982	6,790	960	3,171	2,221	438	32,866	1,774	5,479	18,226	7,387

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JUN	$28,091	$5,731	$14,174	$5,385	$2,801	$105,354	$13,116	$56,079	$19,126	$17,033
JUL	27,791	5,686	14,594	4,928	2,583	99,706	14,684	49,838	17,882	17,302
AUG	32,123	6,588	16,969	5,434	3,132	103,290	14,190	50,198	20,243	18,659
SEP	30,531	6,123	16,055	6,094	2,504	114,357	15,205	50,579	29,268	18,980
OCT	29,039	4,208	16,134	5,775	2,922	110,307	12,436	49,882	29,100	18,889
NOV	29,343	6,636	13,967	5,476	3,264	112,662	12,237	49,249	32,014	19,162
DEC[p]	28,511	6,489	14,889	4,693	2,440	109,632	14,091	47,704	31,450	16,378
1984 TOTAL	249,401	70,128	146,184	47,065	20,844					
1983 TOTAL	258,986	44,893	123,361	38,195	17,717					
12 MONTHS										
1985	323,085	59,986	170,763	60,635	31,701					
1984	258,986	44,893	146,184	47,065	20,844					
1983	249,401	70,128	123,361	38,195	17,717					
1982	115,328	42,594	45,184	19,511	8,039					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1985												
NOV	173	78	27	68	128	$8,488	47	$2,795	25	$1,693	56	$4,000
DEC	163	80	22	61	93	6,319	23	1,359	19	1,347	51	3,613
1986												
JAN	205	130	24	51	110	7,298	45	2,659	19	1,304	46	3,335
FEB	211	136	25	50	97	6,594	45	2,773	18	1,242	34	2,579
MAR	305	211	33	61	115	7,752	57	3,477	23	1,621	35	2,654
APR	379	270	32	77	105	7,354	47	2,939	18	1,299	40	3,116
MAY[p]	344	220	39	85	141	9,837	73	4,608	24	1,742	44	3,487
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
1984 TOTAL	1,862	477	180	1,205	1,344	86,775	200	10,644	198	12,728	946	63,403
5 MONTHS												
1986	1,405	967	114	324	568	38,835	267	16,456	102	7,208	199	15,171
1985	824	316	84	424	467	30,116	113	6,400	65	4,228	289	19,488
1984	823	214	95	514	571	36,270	103	5,459	99	6,389	369	24,422
1983	495	67	148	280	400	23,260	125	5,959	96	5,935	179	11,366

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC* Comm. to Sell	FHLMC* Comm. to Buy	FHLMC* Mtg. Purc.	FHLMC* Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1985										
DEC	$1,858	$1,663	$54,987	$3,365	$3,076	$3,425	$6,095	$6,335	$5,699	$4,520
1986										
JAN	1,315	1,188	58,391	3,964	4,880	5,273	3,709	3,300	10,103	5,298
FEB	2,578	1,159	60,752	2,978	5,526	6,044	4,605	4,268	5,973	5,006
MAR	1,917	1,410	62,310	2,260	7,213	7,128	5,318	5,900	14,853	5,059
APR	3,774	1,631	64,171	2,835	8,223	9,869	6,195	5,593	13,336	6,900
MAY	3,536	1,978	67,312	4,491	na	na	na	na	4,853	3,872
1985 TOTAL	20,225	21,510	—	23,649	30,743	32,601	21,885	20,489	36,101	27,857
1984 TOTAL	21,007	16,721	—	13,546	30,921	32,846	22,952	21,376	70,280	50,496
5 MONTHS										
1986	13,122	7,366	—	16,528	25,842	28,346	19,827	19,061	49,127	28,135
1985	8,825	8,975	—	6,680	14,644	15,480	10,877	9,498	20,814	14,279
1984	8,123	7,958	—	4,836	6,025	6,430	5,081	3,907	15,862	12,995
1983	6,531	7,655	—	6,291	6,410	7,445	7,824	7,391	31,505	20,535

* Year-to-date totals are for three months only

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES: FHA OPINION SURVEY FHA NEW[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA 1 Yr. ARM (1%/Yr.)	FNMA FRM Conv.	APARTMENTS[5]
1986								
JAN	10.78%	10.82%	10.93%	10.89%	10.81%	10.00%	10.375%	12.00%
FEB	10.59	10.49	10.50	10.68	10.83	9.89	10.269	11.63
MAR	9.77	10.06	10.10	10.50	10.62	9.04	9.494	11.09
APR	9.80	9.99	9.99	10.27	10.37	8.49	9.300	10.84
MAY	10.07	10.32	10.33	10.22	10.15	8.70	9.663	10.81
JUN	na	na	na	10.14	10.21	8.80	10.050	11.62

CURRENT SECONDARY MARKET YIELDS

SELECTED SECURITIES

YEAR AND MONTH	GNMA[6]	FNMA[6]	FHLMC[6]	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1986							
JAN	9.99%	10.18%	10.22%	10.74%	9.19%	7.16%	7.71%
FEB	9.75	9.90	9.95	10.21	8.70	7.11	7.63
MAR	9.05	9.23	9.27	9.41	7.78	6.57	7.20
APR	9.01	9.08	9.12	9.26	7.30	6.08	6.60
MAY	9.33	na	na	9.50	7.71	6.19	6.62
JUN	9.59	9.51	9.54	9.65	7.80	6.27	6.71

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1985				
JAN	4	80	99	103
FEB	38	105	120	125
MAR	36	127	145	149
APR	54	171	178	182
MAY	57	162	na	na
JUN	na	179	171	174

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

MORTGAGE BANKING ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED[1]

YEAR AND MONTH	NOT SEASONALLY ADJUSTED									SEASONALLY ADJUSTED			
		1-4 Units				5+ Units							
	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-[3] res.	Total[2]	1-4 Units	5+ Units	Non-[3] res.
1984													
JUL	$ 3,760	$ 3,330	$ 800	$ 530	$ 2,000	$ 0	$ 0	$ 0	$ 430	$3,530	$2,960	$ 0	$460
AUG	3,570	3,070	520	380	2,170	0	0	0	500	3,120	2,600	0	510
SEP	3,050	2,400	550	380	1,470	70	70	0	580	3,380	2,500	120	780
OCT	3,700	3,110	820	470	1,820	0	0	0	590	3,600	2,920	0	750
NOV	3,370	3,090	820	470	1,800	0	0	0	280	3,890	3,610	0	280
DEC	5,250	4,090	1,280	690	2,120	80	0	80	1,080	4,580	3,860	70	770
1983 Total	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1984 Total	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
12 MONTHS[5]													
1984	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
1983	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1982	29,250	24,440	8,510	5,160	10,770	1,580	640	940	3,230				
1981	33,470	25,830	8,380	6,200	11,250	1,740	770	970	5,910				

COMMITMENT ACTIVITY: LONG-TERM MORTGAGE LOANS[1]

YEAR AND MONTH	COMMITMENTS DURING MONTH								OUTSTANDING COMMITMENTS END OF MONTH					
	To Borrowers				From Investors				To Borrowers			From Investors		
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.
1984														
JUL	$ 4,060	$ 2,940	$ 0	$1,120	$ 4,050	$ 3,580	$ 20	$ 450	$10,840	$ 70	$570	$9,870	$250	$1,570
AUG	2,920	2,630	0	290	4,220	3,380	10	830	7,430	40	500	7,730	210	1,600
SEP	2,910	2,640	30	240	2,760	2,400	80	280	7,350	300	500	7,460	480	800
OCT	3,910	3,240	0	670	4,550	4,090	30	430	7,660	170	540	8,400	370	740
NOV	3,430	2,820	0	610	3,880	2,760	170	950	7,460	40	690	6,940	270	1,050
DEC	5,480	4,090	430	960	4,850	3,910	80	860	7,850	100	750	7,810	280	1,170
1983 TOTAL	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1984 TOTAL	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
12 MONTHS[5]														
1984	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
1983	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1982	47,800	36,760	3,330	7,710	46,740	34,380	3,960	8,400						
1981	36,700	30,170	1,200	5,330	44,700	30,410	1,740	12,550						

OUTSTANDING END OF MONTH INVENTORY[1]

YEAR AND MONTH	Total	1-4 Units				5+ Units			Non-res.[3]
		Total	FHA	VA	Conv.	Total	FHA	Conv.	
1984									
JUL	$8,870	$6,990	$1,480	$1,090	$4,420	$730	$0	$730	$1,150
AUG	7,070	5,520	1,060	740	3,720	640	0	640	910
SEP	7,390	5,490	1,010	680	3,800	640	0	640	1,260
OCT	8,060	6,350	1,190	870	4,290	600	0	600	1,110
NOV	8,010	6,280	1,190	850	4,240	590	0	590	1,140
DEC	6,840	6,090	1,500	980	3,610	170	0	170	580

MORTGAGE BANKING ACTIVITY (Cont'd.)

YEAR AND MONTH	COVERAGE[4] 1-4 Units	COVERAGE[4] 5+ Units	COVERAGE[4] Non-[3] res.	SERVICING VOLUME[1] Total	SERVICING VOLUME[1] 1-4 Units	SERVICING VOLUME[1] 5+ Units	SERVICING VOLUME[1] Non.[3] res.	NOTES PAYABLE[1] (End of Month Balances) Total	Comm. Paper	To Banks	To Others
1984											
JUL	55%	31%	91%	$421,420	$317,600	$63,980	$39,840	$41,960	$6,190	$12,710	$23,060
AUG	60	31	113	363,570	282,400	42,060	39,110	47,940	5,750	13,220	28,970
SEP	58	51	45	381,070	302,840	39,300	38,930	59,220	4,520	14,240	40,460
OCT	60	48	45	417,780	339,960	40,660	37,160	57,230	4,830	17,070	35,330
NOV	51	43	57	422,490	350,580	39,790	32,120	54,180	4,820	19,180	30,180
DEC	56	96	88	365,270	321,620	33,110	30,540	42,290	8,390	23,680	10,210

CONSTRUCTION AND LAND LOAN ACTIVITY[1]

YEAR AND MONTH	CONSTRUCTION LOANS CLOSED Total	1-4 Units	5+ Units	Non-[3] res.	DISBURSEMENTS DURING MONTH Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans	END OF MONTH INVENTORY Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans
1984														
JUL	$790	$130	$210	$450	$280	$ 70	$10	$200	$180	$2,760	$ 900	$240	$1,620	$1,120
AUG	410	110	130	170	100	60	0	40	90	2,200	790	190	1,220	830
SEP	440	100	160	180	100	50	10	40	120	2,150	790	180	1,180	800
OCT	400	210	100	90	90	40	10	40	130	2,180	780	220	1,180	870
NOV	210	140	50	20	170	110	20	40	240	3,520	1,380	410	1,730	2,260
DEC	470	270	120	80	430	220	30	180	470	9,240	3,790	790	4,660	3,440

COMMITMENTS TO BORROWERS: AND LAND CONSTRUCTION LOANS[1]

YEAR AND MONTH	ISSUED DURING MONTH Total	1-4 Units	5+ Units	Non-[3] res.	END OF MONTH BALANCES Total	1-4 Units	5+ Units	Non-[3] res.
1984								
JUL	$1,730	$130	$ 60	$1,540	$4,090	$870	$470	$2,750
AUG	770	190	80	500	3,680	850	460	2,370
SEP	760	100	80	580	4,170	760	580	2,830
OCT	710	150	160	400	3,820	860	590	2,370
NOV	380	140	70	170	3,230	680	430	2,120
DEC	790	200	10	580	3,910	930	280	2,700

Notes: [1] All dollar amounts are in millions.

[2] Total is seasonally adjusted separately from components. Total, therefore, may not equal sum of parts.

[3] Series labeled non-residential are also inclusive of farm data.

[4] Percent coverage equals outstanding commitments received from investors divided by the sum of outstanding end of month inventory and outstanding commitments issued to borrowers, all multiplied by 100.

[5] Year-to-date seasonally adjusted series not calculated.